

# Ergomed

H121 results update

US is now the biggest market in the mix

Healthcare services

Ergomed has released its full H121 results. H121 revenue numbers were included in the trading update in July 2021, while the full accounts released last week provided details on profits. In the trading update, management also guided that FY21 adjusted EBITDA would be materially ahead of market expectations, which has since been discounted in the share price, hence last week's announcement delivered no surprises. However, the key takeaway for us was that overall operational momentum continues to be strong, including the first three months of H221 (following the already [stellar performance in FY20](#)). In H121, Ergomed has also launched its expansion into the Japanese market. We have slightly increased our valuation to £751m or 1,536p/share (from 1,445p/share).

Year end	Revenue (£m)	Adjusted EBITDA* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/19	68.3	12.5	19.8	0.0	66.4	N/A
12/20	86.4	19.4	23.7	0.0	55.5	N/A
12/21e	119.6	24.0	34.1	0.0	38.6	N/A
12/22e	136.9	27.9	40.5	0.0	32.5	N/A

Note: \*Adjusted EBITDA and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

## FX headwinds, but strong underlying growth

H121 results were substantially affected by FX headwinds, reflecting the increasing US\$ contribution (now c 63% of the mix) after the US-based MedSource acquisition in December 2020. Total revenues increased to £56.0m, up 48.1% on constant exchange rate basis (CER; 38.8% reported) y-o-y. Like-for-like (excluding MedSource) total service fees (revenues excluding costs that are reimbursed by clients) grew 18.2% CER (11.1% reported). Including the acquisition, total service fees were £47.6m, up 37.7% CER (29.3% reported). Growth was driven by a solid order book (£227.8m, up 51% y-o-y) and healthy new business wins in H121 (£90.8m, up 50.8% y-o-y). This provides high visibility for H221 and into 2022.

## Margins also 'masked' by unfavourable FX rates

H121 gross profit increased to £23.0m, up 24.3% from H120. The total gross margin contraction to 41.1% from 45.8% was partially expected due to increased presence and personnel in the US after the MedSource acquisition in December 2020, but also due to FX headwinds. However, the underlying total service fee gross margin on CER basis was a healthy 48.2% in H121 versus 50.1% a year ago. Adjusted EBITDA increased to £12.1m, up 33% from H120 (£9.1m), while adjusted EPS was 16.8p, up 48.7% from H120 (11.3p).

## Valuation: £751m or 1,536p/share

We keep our FY21 estimates unchanged and modestly increase our EBITDA forecasts starting from 2022 based on improved margins, cost control and integration synergies. After rolling our DCF model forward, our valuation has increased slightly to £751m or 1,536p/share. This implies an EV/EBITDA multiple of 30.0x (FY21e). Ergomed trades at a modest premium on EV/EBITDA of 25.5x vs the peer average of 24.2x, but at a discount to Medpace on 31.8x. Flexing our DCF assumptions (long-term sales growth and profit margins), our bull case stands at 2,086p/share and our bear case at 1,072p/share (details in our [Outlook report](#)).

04 October 2021

**Price** 1,315p

**Market cap** £643m

Net cash (£m) at 30 June 2021 24.6

Shares in issue 48.9m

Free float 80.2%

Code ERGO

Primary exchange AIM

Secondary exchange Frankfurt Xetra

### Share price performance



%	1m	3m	12m
Abs	8.2	(2.7)	116.4
Rel (local)	7.1	(3.9)	77.8
52-week high/low	1,430p		585p

### Business description

Ergomed is a global full-service contract research outsourcing (CRO) business with a core focus on the US and EU. It provides Phase I-III clinical services in addition to post-marketing pharmacovigilance services through its PrimeVigilance division. Ergomed is predominantly focused on oncology, orphan drugs, rare diseases and pharmacovigilance.

### Next events

Trading update	January 2022
Additional bolt-on acquisitions	2021/22

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## H121 update: Operational momentum continues

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### PrimeVigilance: Expanding to Japan

H121 revenues in the PrimeVigilance segment increased to £28.8m, up 16.2% CER (10.3% reported) y-o-y. Gross margin was largely flat at 50.7% versus 51.3% last year. One notable development in H121 was the launch of the expansion process in Japan. The Japan office is now fully operational, with local pharmacovigilance experts providing fully integrated PV services.

Clearly, the Japanese market has unique characteristics and, as a developed country, no shortage of competitors. Ergomed has been subcontracting some work in Japan, but will now have a local presence. During the analyst call, management explained that due to the nature of its business, Ergomed can compete with local PV players from now. To compete in the CRO market, it will likely need to acquire a local player.

H121 revenues from Asia were £3.3m (versus total revenues of £56.0m). Japan is the fourth largest pharmaceutical market in the world, so even moderate success in this region could translate into a meaningful addition to sales. We believe management might try to emulate the successful expansion in the US. As recently as FY19, the US made up 27% of the total revenue mix, while after two acquisitions in both business segments (CRO and PV) over the course of 2020 (and organic growth), the US now represents 63% of the mix.

### CRO: Strong post-pandemic rebound continues

Ergomed's total CRO revenues in H120 increased to £27.2m, up 106.4% CER (or 90.2% reported). Like-for-like (excluding MedSource) revenues increased to £16.6m, up 24.5% CER (16.1% reported). MedSource's performance during the first full half-year after acquisition was described as good. Furthermore, the parties agreed to accelerate the earnout agreed during the takeover in December 2020. Ergomed will make the final payment of \$3.8m (£2.7m) to MedSource shareholders in Q321, which will allow it to complete the integration.

For the near term CRO outlook, the company envisages few, if any, disruptions like those experienced last winter (due to the nature of the business, PV delivered a solid performance despite the pandemic). Ergomed is now also involved in a number of COVID-19 projects in its CRO and PV businesses, which could act as a mitigating factor in the case of potential disruptions this winter, or as a boost to performance (albeit no financial details about the size of COVID-19-related work were provided).

## Estimate changes and near-term catalysts

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Following the H121 results, we keep our FY21 estimates unchanged. In FY22 we slightly increased adjusted EBITDA margin by reducing SG&A costs to reflect Ergomed/MedSource synergies that we believe could be achieved sooner than we thought now that the integration is complete (Exhibit 1). Our total FY21, FY22 and FY23 revenue estimates are unchanged at £119.6m, £136.8m and £161.3m, respectively. Our FY22 adjusted EBITDA margin improved slightly to 20.4% (from 19.8%). Our adjusted EBITDA estimates are £24.0m for FY21 (unchanged) and £27.9m for FY22 (vs £27.1m previously).

Net cash was £24.6m at end-H121 versus £19.0m at end-FY20. Ergomed continues to be debt free, but still has access to facilities of £30m. The near-term catalysts are as follows:

- Bolt-on acquisitions: the strong balance sheet and access to debt (£30m facility available) position Ergomed very well to consider further inorganic growth opportunities.

- A reverse in US\$/£ rate could lead to an unexpected positive catalyst and continued weakness would mean further headwinds now that the US has become a major market.
- Next trading update is expected in January 2022.

**Exhibit 1: Key changes to forecasts**

£m	FY20	FY21e			FY22e			FY23e
	Actual	Old	New	Change (%)	Old	New	Change (%)	New
<b>Total revenues</b>	<b>86.4</b>	<b>119.6</b>	<b>119.6</b>	<b>0.0%</b>	<b>136.8</b>	<b>136.8</b>	<b>0.0%</b>	<b>161.3</b>
– PrimeVigilance	55.1	63.6	63.6	0.0%	73.6	73.6	0.0%	88.2
– CRO	31.3	56.0	56.0	0.0%	63.3	63.3	0.0%	73.1
O/W pass-through	7.6	13.6	13.6	0.0%	15.3	15.3	0.0%	17.7
<b>Adjusted EBITDA</b>	<b>19.4</b>	<b>24.0</b>	<b>24.0</b>	<b>0.0%</b>	<b>27.1</b>	<b>27.9</b>	<b>2.8%</b>	<b>34.9</b>
– Adj. EBITDA margin	22.4%	20.0%	20.0%	0.0pp	19.8%	20.4%	0.6pp	21.6%
Adjusted EBIT	14.5	19.8	19.8	0.0%	23.0	23.7	3.3%	30.7
– Adj. EBIT margin	16.8%	16.6%	16.6%	0.0pp	16.8%	17.3%	0.6pp	19.0%
Adjusted EPS (p)	23.7	34.1	34.1	0.0%	39.3	40.5	3.2%	52.1

Source: Edison Investment Research

**Exhibit 2: Ergomed base case DCF model**

£'000s	2021e	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e	2030e
Revenue	119,600	136,877	161,301	187,109	215,487	246,374	279,634	315,054	352,336	391,093
Growth (%)	38.4%	14.4%	17.8%	16.0%	15.2%	14.3%	13.5%	12.7%	11.8%	11.0%
Adj. EBIT	19,829	23,740	30,709	37,422	44,893	53,381	62,918	73,513	85,148	97,773
Margin (%)	16.6%	17.3%	19.0%	20.0%	20.8%	21.7%	22.5%	23.3%	24.2%	25.0%
Tax	(3,536)	(4,279)	(5,603)	(6,932)	(8,325)	(9,908)	(11,689)	(13,668)	(15,843)	(18,205)
Rate (%)	-19%	-19%	-19%	-19%	-19%	-19%	-19%	-19%	-19%	-19%
D&A	4,150	4,150	4,150	4,150	4,150	4,150	4,150	4,150	4,150	4,150
Working capital	(3,226)	(1,388)	(2,541)	(2,415)	(2,377)	(2,677)	1,283	2,963	4,095	4,639
Capex	(3,550)	(3,550)	(3,550)	(1,733)	(649)	(893)	(771)	(832)	(802)	(817)
<b>Operating free cash flow</b>	<b>13,668</b>	<b>18,674</b>	<b>23,165</b>	<b>30,492</b>	<b>37,692</b>	<b>44,053</b>	<b>55,891</b>	<b>66,126</b>	<b>76,748</b>	<b>87,540</b>

	Value	Value /share
DCF for forecast period (2021 to 2023)	48.6	99p
DCF for transition period (2023 to 2030)	209.2	428p
Terminal value	461.9	945p
<b>Enterprise value</b>	<b>719.7</b>	<b>1,472p</b>
Net cash/(debt), FY21e	31.4	64p
<b>Equity value</b>	<b>751.2</b>	<b>1,536p</b>

Source: Edison Investment Research. Note: 10% WACC.

**Exhibit 3: Ergomed comparable companies**

Company	Price	EV	EV/EBITDA (x)				EV/sales (x)				P/E (x)			
			2020	2021e	2022e	2023e	2020	2021e	2022e	2023e	2020	2021e	2022e	2023e
<b>Ergomed*</b>	<b>1,315p</b>	<b>£611m</b>	<b>31.6x</b>	<b>25.5x</b>	<b>21.9x</b>	<b>17.5x</b>	<b>7.1x</b>	<b>5.1x</b>	<b>4.5x</b>	<b>3.8x</b>	<b>58.0x</b>	<b>40.1x</b>	<b>33.7x</b>	<b>26.2x</b>
Syneos	\$96.0	\$12,615m	19.9x	16.6x	14.8x	13.4x	2.9x	2.4x	2.2x	2.1x	28.2x	22.0x	19.1x	16.6x
ICON	\$281.5	\$21,908m	46.1x	24.3x	16.0x	14.3x	7.8x	4.1x	2.8x	2.6x	43.1x	30.8x	25.3x	21.6x
Medpace	\$195.2	\$6,716m	35.8x	31.8x	25.8x	22.5x	7.3x	5.9x	4.9x	4.4x	50.8x	43.9x	38.6x	33.6x
<b>Average</b>			<b>33.9x</b>	<b>24.2x</b>	<b>18.9x</b>	<b>16.7x</b>	<b>6.0x</b>	<b>4.1x</b>	<b>3.3x</b>	<b>3.0x</b>	<b>40.7x</b>	<b>32.2x</b>	<b>27.6x</b>	<b>23.9x</b>

Source: Edison Investment Research, Refinitiv. Note: \*Edison estimates. We note the merger of ICON and PRA Health Sciences announced on 24 February 2021.

**Exhibit 4: Financial summary**

Accounts: IFRS, year end 31 December (£000s)	2019	2020	2021e	2022e	2023e
<b>INCOME STATEMENT</b>					
Total revenues	68,255	86,391	119,600	136,877	161,301
Cost of sales	(29,790)	(38,686)	(58,600)	(59,131)	(69,682)
Reimbursable expenses	(8,940)	(8,055)	(22,650)	(16,379)	(18,967)
Gross profit	29,525	39,650	54,120	61,367	72,651
Gross margin %	43%	46%	45%	45%	45%
SG&A (expenses)	(23,513)	(27,803)	(35,064)	(38,396)	(42,708)
R&D costs	(545)	(152)	(203)	(207)	(211)
Other income/(expense)	51	1,839	0	0	0
Exceptionals and adjustments	3,265	993	976	976	976
Reported EBITDA	9,230	18,378	23,003	26,914	33,883
Depreciation and amortisation	3,712	4,844	4,150	4,150	4,150
Reported EBIT	5,518	13,534	18,853	22,764	29,733
Finance income/(expense)	(245)	(395)	(245)	(245)	(245)
Other income/(expense)	(286)	(511)	0	0	0
Reported PBT	4,987	12,628	18,608	22,519	29,488
Income tax expense (includes exceptionals)	583	(2,936)	(3,536)	(4,279)	(5,603)
Reported net income	5,570	9,692	15,073	18,241	23,885
Basic average number of shares, m	46.6	48.5	48.9	48.9	48.9
Basic EPS (p)	12.0	20.0	30.8	37.3	48.9
Adjusted EBITDA	12,495	19,371	23,979	27,890	34,859
Adjusted EBIT	8,783	14,527	19,829	23,740	30,709
Adjusted PBT	8,637	14,442	20,184	24,095	31,064
Adjusted EPS (p)	19.8	23.7	34.1	40.5	52.1
Adjusted diluted EPS (p)	19.8	22.7	32.8	39.1	50.2
Order book	124,100	193,000	246,902	276,736	423,642
<b>BALANCE SHEET</b>					
Property, plant and equipment	1,110	1,742	1,742	1,742	1,742
Right-of-use assets	5,171	4,715	4,715	4,715	4,715
Goodwill	13,380	24,605	24,605	24,605	24,605
Intangible assets	2,755	9,618	9,018	8,418	7,818
Other non-current assets	2,616	4,310	4,310	4,310	4,310
Total non-current assets	25,032	44,990	44,390	43,790	43,190
Cash and equivalents	14,259	18,994	31,440	48,892	70,836
Trade and other receivables	14,359	22,224	27,852	32,821	40,310
Other current assets	3,382	7,009	7,009	7,009	7,009
Total current assets	32,000	48,227	66,301	88,723	118,156
Lease liabilities	3,716	3,128	3,128	3,128	3,128
Long term debt		0	0	0	0
Other non-current liabilities	635	2,529	2,529	2,529	2,529
Total non-current liabilities	4,351	5,657	5,657	5,657	5,657
Trade and other payables	10,373	15,702	18,104	21,685	26,633
Lease liabilities	1,718	1,978	1,978	1,978	1,978
Other current liabilities	3,770	17,388	17,388	17,388	17,388
Total current liabilities	15,861	35,068	37,470	41,051	45,999
Equity attributable to company	36,820	52,492	67,565	85,805	109,690
<b>CASH FLOW STATEMENT</b>					
Profit before tax	4,987	12,628	18,608	22,519	29,488
Cash from operations (CFO)	11,788	18,084	15,997	21,003	25,494
Capex	(996)	(974)	(3,550)	(3,550)	(3,550)
Acquisitions & disposals net	(107)	(11,969)	0	0	0
Other investing activities	(1,728)	0	0	0	0
Cash used in investing activities (CFIA)	(2,831)	(12,760)	(3,550)	(3,550)	(3,550)
Net proceeds from issue of shares	1,427	(157)	0	0	0
Movements in debt	(1,677)	(2,189)	0	0	0
Other financing activities	0	0	0	0	0
Cash from financing activities (CFF)	(250)	(477)	0	0	0
Increase/(decrease) in cash and equivalents	8,707	4,847	12,447	17,453	21,944
Currency translation differences and other	363	(113)	0	0	0
Cash and equivalents at start of period	5,189	14,259	18,993	31,440	48,892
Cash and equivalents at end of period	14,259	18,993	31,440	48,892	70,836
Net (debt)/cash	14,259	18,993	31,440	48,892	70,836

Source: Ergomed accounts, Edison Investment Research

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